



# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 8-K

**CURRENT REPORT  
PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

Date of Report (Date of earliest event reported): February 21, 2006

### **VASCO Data Security International, Inc.**

(Exact name of registrant as specified in charter)

**Delaware**

**000-24389**

**36-4169320**

(State or other juris-  
diction of incorporation)

(Commission  
File Number)

(IRS Employer  
Identification No.)

1901 South Meyers Road, Suite 210  
Oakbrook Terrace, Illinois

60181

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (630) 932-8844

N/A

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

## ITEM 2.02 Results of Operations and Financial Condition

On February 21, 2006, VASCO Data Security International, Inc. (VASCO) issued a press release providing a financial update for the fourth quarter and year ended December 31, 2005. The full text of the press release is attached as Exhibit 99.1 to this Current Report on Form 8-K.

On February 21, 2006, VASCO held a conference call with investors to discuss VASCO's fourth quarter earnings and results of operations for the year ended December 31, 2005. A script read by officers of VASCO during the conference call is furnished as Exhibit 99.2 to this Current Report on Form 8-K.

The press release and the comments by VASCO during the conference call contained a non-GAAP financial measure within the meaning of the Securities and Exchange Commission's Regulation G. For purposes of Regulation G, a non-GAAP financial measure is a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows (or equivalent statements) of the issuer; or includes amounts, or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measure so calculated and presented.

The press release contained a reference to EBITDA and provided a reconciliation of EBITDA to net income on the face of the Consolidated Statement of Operations. EBITDA, which is earnings before interest, taxes, depreciation and amortization, is computed by adding back net interest expense, income tax expense, depreciation expense, and amortization expense to net income as reported.

We use EBITDA as a measure of performance, a simplified tool for use in communicating our performance to investors and analysts and for comparisons to other companies within our industry. As a performance measure, we believe that EBITDA presents a view of our operating results that is most closely related to serving our customers. By excluding interest, taxes, depreciation and amortization we are able to evaluate performance without considering decisions that, in most cases, are not directly related to meeting our customers requirements and were either made in prior periods (e.g., depreciation and amortization), or deal with the structure or financing of the business (e.g., interest) or reflect the application of regulations that are outside of the control of our management team (e.g., taxes). Similarly, we find that the comparison of our results to those of our competitors are facilitated when we do not need to consider the impact of those items on our competitors' results.

EBITDA should be considered in addition to, but not as a substitute for, other measures of financial performance reported in accordance with accounting principles generally accepted in the United States. While we believe that EBITDA, as defined above, is useful within the context described above, it is in fact incomplete and not a measure that should be used to evaluate the full performance of the Company or its prospects. Such evaluation needs to consider all of the complexities associated with our business including, but not limited to, how past actions are affecting current results and they may affect future results, how we have chosen to finance the business and how regulations and the other aforementioned items affect the final amounts that are or will be available to shareholders as a return on their investment. Net income determined in accordance with U.S. GAAP is the most complete measure available today to evaluate all elements of the our performance. Similarly, our Consolidated Statement of Cash Flows provides the full accounting for how we have decided to use resources provided to us from our customers, lenders and shareholders.

**ITEM 9.01 Financial Statements and Exhibits**

(c) Exhibits

Exhibit Number	Description
99.1	Press release, dated February 21, 2006, providing financial update of VASCO Data Security International, Inc. for the fourth quarter and year ended December 31, 2005.
99.2	Text of script for February 21, 2006 Earnings Conference Call.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Date: February 21, 2006

VASCO Data Security International, Inc.

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(Registrant)

By: /s/Clifford K. Bown

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Clifford K. Bown  
Chief Financial Officer

## EXHIBIT INDEX

Exhibit No	Description
99.1	Press release, dated February 21, 2006, announcing financial update of VASCO Data Security International, Inc. for the fourth quarter and year ended December 31, 2005.
99.2	Text of script for February 21, 2006 Earnings Conference Call.

VASCO Reports Results for Fourth Quarter and Full-Year 2005

**Revenues increased 88% over fourth quarter and 83% over full-year 2004 on a record number of Digipass products shipped. Operating income increased 182% over fourth quarter and 97% over full-year 2004. Both revenue and operating income for the quarter and full-year are the best in the Company's history. Financial results for the periods ended December 31, 2005 and guidance for full-year 2006 to be discussed on conference call today at 10:00 a.m. E.S.T.**

OAKBROOK TERRACE, Ill., and BRUSSELS, Belgium, February 21, 2006 – VASCO Data Security International, Inc. (Nasdaq: VDSI) ( www.vasco.com), today reported financial results for the fourth quarter and full-year ended December 31, 2005.

Revenues for the fourth quarter of 2005 increased 88% to \$17,519,000 from \$9,298,000 in 2004 and, for the full-year 2005, increased 83% to \$54,579,000 from \$29,893,000 in 2004.

Net income available to common shareholders for the fourth quarter of 2005 was \$2,962,000, or \$0.08 per diluted share and compares to \$481,000, or \$0.02 per diluted share in 2004. Net income available to common shareholders for the full-year 2005 was \$7,687,000, or \$0.21 per diluted share compared to income of \$3,021,000, or \$0.09 per diluted share in 2004.

Financial Highlights:

- Results reflect the twelfth consecutive quarter of operating profit and positive earnings before interest, taxes, depreciation and amortization (“EBITDA”).
- Results reflect the seventh consecutive quarter-over-quarter increase in revenue. Revenue for the fourth quarter 2005 was 32% higher than the third quarter of 2005.
- Gross profit was \$11,035,000 or 63% of revenue for the fourth quarter and \$34,438,000 or 63% of revenue for the full-year 2005. Gross profit was \$6,032,000 or 65% of revenue for the fourth quarter and \$20,709,000 or 69% of revenue for the full-year 2004.
- Operating expenses for the fourth quarter and full-year 2005 were \$6,827,000 and \$23,485,000, respectively, an increase of 50% from \$4,539,000 reported for the fourth quarter 2004 and an increase of 55% from \$15,157,000 reported for the full-year 2004.
- Operating income for the fourth quarter and full-year 2005 was \$4,208,000 and \$10,953,000, respectively, an increase of \$2,715,000, or 182%, from \$1,493,000 reported for the fourth quarter of 2004 and an increase of \$5,401,000, or 97%, from the \$5,552,000 reported for the full-year 2004. Operating income as a percentage of revenue for the fourth quarter and full-year 2005 was 24% and 20%, respectively, compared to 16% and 19% for the comparable periods in 2004.

- Other income/expense, which primarily includes exchange gains and losses, was expense of \$7,000 for the fourth quarter 2005 and income of \$506,000 for the full-year 2005 and compares to expense of \$538,000 for the fourth quarter of 2004 and expense of \$539,000 for the full-year 2004.
- Net income for the fourth quarter and full-year 2005 was \$2,962,000 and \$7,701,000, respectively, and compares to \$516,000 and \$3,253,000 reported for the same periods in 2004.
- Earnings before interest, taxes, depreciation and amortization was \$4,456,000 and \$12,536,000 for the fourth quarter and for the full-year 2005, respectively, an increase of 276% from \$1,186,000 reported for the fourth quarter of 2004 and an increase of 118% from \$5,747,000 reported for the full-year 2004.
- Net cash balances, total cash and cash equivalents less bank borrowings, at December 31, 2005 totaled \$13,970,000 compared to \$9,272,000 and \$8,220,000 at September 30, 2005 and December 31, 2004, respectively.

Operational and Other Highlights:

- VASCO won 251 new customers in Q4 2005 (21 banks and 230 corporate network access customers) and 821 for full-year 2005. Year-to-date new customers include 89 new banks and 732 corporate network access customers.
- VASCO shipped approximately 2,425,000 Digipass authentication products in the fourth quarter and approximately 7,340,000 for the full-year 2005, an increase of 159% over the number of Digipass products shipped in the full-year 2004. The 2,425,000 units shipped in the fourth quarter of 2005 reflected an increase of 1,360,000 units, or 128%, over the 1,065,000 Digipass products shipped in the fourth quarter of 2004.
- Rabobank (The Netherlands) to Use VASCO's Digipass 810 for EMV-CAP and Digipass Two Factor Authentication
- Lloyds TSB Trials VASCO Digipass with 30,000 Online Banking Customers
- Friesland Bank (The Netherlands) to Use VASCO's Digipass 815 Secure Card Reader for Retail Banking
- UK Online Gambling Company Redbet Uses VASCO's Digipass 260 to Secure Online Gambling Applications
- Dutch Online Service Provider DigiNotar Uses VASCO's Digipass GO3 to Secure Online Authentication Services
- VASCO and SAB2i Announce Solution Partnership
- VASCO launches VACMAN Controller for Hardware Security Module (HSM)



- VASCO launches Hyper-Portable Digipass 100, Digipass Strong User Authentication on Flexible Smart Card
- VASCO selected by *Red Herring* magazine as one of the inaugural *Red Herring* Small Cap 100

“The results of the fourth quarter and full-year 2005 demonstrate clearly that our strategies are working,” said Ken Hunt, VASCO’s CEO and Chairman. “Our strategy of being the high-volume, high-quality, low-cost producer is clearly paying off as our unit volume for the quarter exceeded our nearest competitor by approximately 900,000 units, or 60%. Efficiencies created by our operating model were also strongly evident as our operating earnings, as a percentage of revenue, were 24% for the quarter and 20% for the full-year. As we look forward, I believe our vision of being the full-option, all-terrain authentication company will serve our customers well and maintain our market leading position.”

“The fourth quarter in each of the last two years has reflected important changes in our business,” said Jan Valcke, VASCO’s President and COO. “Last year, the fourth quarter showed a significant increase in unit volume as the demand for consumer level authentication increased substantially. In the fourth quarter of this year, we saw a higher sense of urgency from our customers as the time lag between placing an order and the delivery of the product became shorter. In the fourth quarter of this year, we sold and delivered approximately \$4.8 million of new business from October 27<sup>th</sup>, the date that we announced our backlog for the quarter, through the end of the quarter. We have also seen continuing strong demand through the 2005 holiday season and into 2006. Our current backlog for orders to be shipped in Q1 2006 is \$12.8 million, an increase of \$2.1 million or 20% from the backlog for Q1 2005. The current backlog is \$1.4 million or 12% higher than our results for the full first quarter of 2005.”

Cliff Bown, Executive Vice President and CFO added, “Our balance sheet continues to strengthen as a result of the strong operating performance. Net cash balances, cash and cash equivalents less bank borrowings, increased \$4,698,000 or 51% from September 30, 2005 and our working capital increased by \$3,504,000 or 27% from September 30, 2005. At December 31, 2005 our working capital balance was \$16,325,000. Days Sales Outstanding (DSO) in net accounts receivable increased to approximately 63 days at December 31, 2005 from 59 days at September 30, 2005 due in large part to the significant amount of shipments in the month of December.”

#### Conference Call Details

In conjunction with this announcement, VASCO Data Security International, Inc. will host a conference call today, February 21, 2006, at 10:00 a.m. EST – 16:00h CET. During the Conference Call, Mr. Ken Hunt, CEO, Mr. Jan Valcke, President and COO, and Mr. Cliff Bown, CFO, will discuss VASCO’s Results for the Fourth Quarter and Full-year 2005.

To participate in this Conference Call, please dial one of the following numbers:

USA/Canada: +1 888 694 4769

International: +1 973 582 2757

And mention access code: VASCO to be connected to the Conference Call.

The Conference Call is also available in listen-only mode on [www.vasco.com](http://www.vasco.com). Please log on 15 minutes before the start of the Conference Call in order to download and install any necessary software. The recorded version of the Conference Call will be available on the VASCO website 24 hours a day.

**VASCO Data Security International, Inc.**  
**Consolidated Statements of Operations**  
(In thousands, except per share data)  
(Unaudited)

	Three months ended December 31,		Twelve months ended December 31,	
	2005	2004	2005	2004
Net revenues	\$ 17,519	\$ 9,298	\$ 54,579	\$ 29,893
Cost of goods sold	6,484	3,266	20,141	9,184
Gross profit	11,035	6,032	34,438	20,709
Operating costs:				
Sales and marketing	4,525	2,942	14,784	9,160
Research and development	964	705	3,579	2,441
General and administrative	1,351	810	4,556	3,191
Restructuring recovery	(172)	—	(172)	(32)
Amortization of purchased intangible assets	159	82	738	397
Total operating costs	6,827	4,539	23,485	15,157
Operating income	4,208	1,493	10,953	5,552
Interest income, net	37	32	69	120
Other income (expense), net	(7)	(538)	506	(539)
Income before income taxes	4,238	987	11,528	5,133
Provision for income taxes	1,276	471	3,827	1,880
Net income	2,962	516	7,701	3,253
Preferred stock dividends	—	(35)	(14)	(232)
Net income available to common shareholders	\$ 2,962	\$ 481	\$ 7,687	\$ 3,021
Net income per share				
Basic	\$ 0.08	\$ 0.02	\$ 0.22	\$ 0.09
Diluted	\$ 0.08	\$ 0.02	\$ 0.21	\$ 0.09
Weighted average common shares outstanding:				
Basic	36,089	33,167	35,429	32,216
Diluted	37,789	34,568	37,244	33,128

**VASCO Data Security International, Inc.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands)  
**UNAUDITED**

	December 31,	
	2005	2004
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 16,962	\$ 8,138
Restricted cash	181	82
Accounts receivable, net	12,083	5,965
Inventories, net	1,570	1,346
Prepaid expenses	726	791
Deferred income taxes	117	23
Foreign sales tax receivable	89	313
Other current assets	451	404
Total current assets	32,179	17,062
Property and equipment, net	982	838
Intangible assets, net	1,054	1,243
Goodwill	6,665	250
Investment in and notes receivable from Secured Services, Inc.	600	820
Other assets	25	37
<b>Total assets</b>	\$ 41,505	\$ 20,250
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 4,753	\$ 3,065
Bank borrowings	3,173	—
Deferred revenue	1,765	620
Accrued wages and payroll taxes	2,329	1,887
Income taxes payable	1,547	435
Other accrued expenses	2,287	1,060
Total current liabilities	15,854	7,067
Long term deferred warranty	256	152
<b>Stockholders' equity:</b>		
Series D Convertible Preferred Stock	—	1,504
Common stock	36	34
Additional paid-in capital	59,625	51,825
Deferred compensation	(404)	—
Accumulated deficit	(32,984)	(40,672)
Accumulated other comprehensive income (loss) - cumulative translation adjustment	(878)	340
Total stockholders' equity	25,395	13,031
<b>Total liabilities and stockholders' equity</b>	\$ 41,505	\$ 20,250

Reconciliation of Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”) to net income;

In Thousands

	Three Months Ended December 31,		Twelve Months Ended December 31,	
	2005	2004	2005	2004
	(unaudited)		(unaudited)	
EBITDA	\$ 4,456	\$ 1,186	\$ 12,536	\$ 5,747
Interest income, net	(37)	(32)	(69)	(120)
Provision for income taxes	1,276	471	3,827	1,880
Depreciation and amortization	255	231	1,077	734
Net income	\$ 2,962	\$ 516	\$ 7,701	\$ 3,253

**About VASCO:** VASCO designs, develops, markets and supports patented user authentication products for the financial world, remote access, e-business and e-commerce. VASCO’s user authentication software is delivered via its Digipass hardware and software security products. With over 20 million Digipass products sold and delivered, VASCO has established itself as a world-leader for strong User Authentication with over 440 international financial institutions and over 2,300 blue-chip corporations and governments located in more than 100 countries.

Forward Looking Statements

Statements made in this news release that relate to future plans, events or performances are forward-looking statements. Any statement containing words such as “believes,” “anticipates,” “plans,” “expects,” and similar words, is forward-looking, and these statements involve risks and uncertainties and are based on current expectations. Consequently, actual results could differ materially from the expectations expressed in these forward-looking statements.

Reference is made to the Company’s public filings with the US Securities and Exchange Commission for further information regarding the Company and its operations.

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Ken Hunt:

Good morning everyone. For those listening in from Europe, good afternoon, and from Asia, good evening. We have continuing good news to discuss with you today!

My name is Ken Hunt, and I am the Chairman, Founder & CEO of VASCO Data Security International, Inc. On the call with me today are Jan Valcke, our President & Chief Operating Officer, and Cliff Bown our EVP and Chief Financial Officer.

Before we begin the conference call, I need to brief all of you on "Forward Looking Statements."

**Forward Looking Statements**

**STATEMENTS MADE IN THIS CONFERENCE CALL THAT RELATE TO FUTURE PLANS, EVENTS OR PERFORMANCES ARE FORWARD-LOOKING STATEMENTS. ANY STATEMENT CONTAINING WORDS SUCH AS "BELIEVES," "ANTICIPATES," "PLANS," "EXPECTS," AND SIMILAR WORDS, IS FORWARD-LOOKING, AND THESE STATEMENTS INVOLVE RISKS AND UNCERTAINTIES AND ARE BASED ON CURRENT EXPECTATIONS. CONSEQUENTLY, ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THE EXPECTATIONS EXPRESSED IN THESE FORWARD-LOOKING STATEMENTS. I DIRECT YOUR ATTENTION TO THE COMPANY'S FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION FOR A DISCUSSION OF SUCH RISKS AND UNCERTAINTIES IN THIS REGARD.**

**General Comments – Ken Hunt**

Today, we are going to review the results for 4<sup>th</sup> quarter and full year, 2005. As always, we will host a question and answer session after the conclusion of management's prepared remarks. If possible, I would like to budget one hour total for this conference call. If you can limit your questions to one or two, it would be appreciated.

The results of the fourth quarter confirm once again that our strategies are working worldwide. Even though the fourth quarter is traditionally a strong quarter, we were especially pleased with the strong second half of the quarter, resulting in our seventh consecutive quarterly increase in revenues. The increases in revenues have been combined with increases in operating productivity and margins. Revenues for the 4th Quarter were \$17, 519,000, up 32% sequentially over 3rd Quarter 2005, and an 88% increase over the comparable 4th Quarter of 2004. Revenues for full year 2005 vs. 2004 were up 83%.

New accounts continued to grow during the 4th Quarter. During the quarter we sold an additional 251 new accounts, including 21 new banks, and 230 new Corporate Network Access customers. Almost all of these Corporate Network Access new accounts and many of the new bank customers were generated through our distributor and reseller partners. Program-to-date we have signed 45 distributors who, in turn, service a network of over 1,500 resellers.

For full year 2005, we sold 821 new accounts including 89 new banks and 732 new Corporate Network Access accounts. Comparatively, for all of 2004, we produced 543 new accounts, including 70 banks and 473 corporate customers.

We now have over 440 banks and over 2,300 network access accounts including corporations, federal, state and local governments as customers located in over 100 countries around the world.

**VASCO's Sustainable, Repeatable Sales Model:**

For 12 quarters now, I have sung the same song. Namely, that VASCO has developed a sustainable, repeatable sales model. Our bank customers launch multi-year projects that are supported by our strong authentication products. These projects are directed towards large corporate and consumer audiences and are rolled out over 2-4 years. Many of our bank customers secure their orders with firm 12-month Purchase Orders giving us great visibility for our future revenue flow. The 228 total new bank customers we signed in 2003, 2004, 2005, are now in various stages of their 2-4 year roll-out's, adding to the sustainable, repeatable revenue flow that we see from other long-standing banking customers, some going back to 1987. This has created a "layering or stacking effect" and is driving our top line revenue and guidance.

**Full-Option, ALL-Terrain Model:**

This is VASCO's new strategy. We will still maintain the "high volume, high-quality, low cost producer" strategy that has driven our business so rapidly. However, in order to further penetrate and protect our existing and growing customer base, our plan is to offer a compelling and flexible platform that supports not only our own growing array of strong authentication products, but also those of our partners, as well. This will include not only our traditional Digipass "Hardware authentication products," but also a discrete selection of alternative authentication products that can be easily deployed to an ever-growing number of users across a broad number of vertical markets and industries. This new and revised strategy will continue to drive our units and revenue. You will hear more about our new product strategy during Jan Valcke's presentation later in this call.

We sold and shipped approximately 2.4 million Digipass units during 4th Quarter 2005, once again demonstrating the effectiveness our strategies, focus and execution. If you looked back over the last seven quarters, you would see that the quantity of Digipass units shipped has increased in each successive quarter with the most significant ramp up in volume beginning the fourth quarter of 2004. In Q4 2004, we shipped more than one million units for the first time in the Company's history. Program-to-date, approximately 20 million Digipass units have been sold and shipped through year end 2005, excluding an estimated 2.5 million units sold by AOS prior to our acquisition. We expect that our unit sales will continue to accelerate as we develop new markets and identify new audiences for the Company's products.

Strategically, VASCO will continue to focus on retail and consumer audiences, those individuals that are doing on-line financial transactions of all types. These could be Internet consumers using an EMV smart card. These could be B-to-C users of all sorts, including wagering, auction, and subscription services. And, of course, there will be a growing number of banking customers doing their on-line banking in a safe and secure environment. In a growing number of countries around the world, most recently in Hong Kong, governments and associations are demanding that their financial institutions deploy strong, two-factor authentication. VASCO will continue to benefit from this trend.

As everyone is aware now, a very strong banking industry directive was issued on October 12<sup>th</sup> here in the United States by the FFIEC, an umbrella group of regulators that includes the FDIC. The FDIC has distributed “guidance” to all of its Supervised Banks (Commercial and Savings).

This “guidance” is not as crystal clear as it is in Honk Kong. In Hong Kong they are explicit, they require banks to deploy to every customer, two-factor authentication, a user name and a physical device – a security token, a USB Stick, a smart card. The FDIC guidance is more interpretive. They suggest that every bank perform a security assessment on every application to determine what they think is appropriate. The recent announcement of our new strategy, Full-Option, All-Terrain security is an acknowledgement that the banking market will adopt a wide-range of security solutions. With our broader, discrete layers of security, we are prepared to meet the security requirements of the banks at the level they believe is appropriate.

In order to maximize our results in the banking market, we will continue to focus on the largest banks directly with our own sales organization. Around the world, we have found great success working with agents and resellers as partners in countries where we do not have a direct presence. When opportunities present themselves through those partners, we leap into action, immediately deploying VASCO troops to the scene of the action. In other countries, including the United States, we work with partners like Fiserv/ITI, large IT banking outsourcers who resell VASCO’s products to their existing customers, making it possible for us to reach thousands of small and mid-sized community banks and their millions of Internet banking clients.

#### **Introduce Jan Valcke:**

At this time I would like to introduce Jan Valcke, VASCO’s President and Chief Operating Officer. Jan congratulations to you and your team on another great quarter.

#### **Comments By Jan**

Thank you, Ken.

Ladies and gentlemen, at the beginning of 2003, VASCO became successful because of its focus on strong authentication. We were good at what we were doing, and the market appreciated that.

Now, three years later, we are the global number 1 provider of strong authentication products.

On the client side, there are four authentication technologies:

- password technologies, including TAN and scratch lists, q&a sessions, matrix cards, etcetera
- one-time password technologies, VASCO’s stronghold, its successful hardware- and software Digipass family
- Certificates/PKI
- Biometrics

VASCO integrates the 4 authentication technologies **on one, unique platform, VACMAN Controller.**



VACMAN Controller is the backbone of our success, the core product that the end-user doesn't see. It is an easy to install, easy to maintain server authentication product that supports over 15 algorithms, all operating systems, and the four client authentication products we have discussed before.

VACMAN Controller is embedded into the security and Internet infrastructures of over 100 solution partners. VACMAN Controller is also the core of VASCO's Identikey Server, an authentication server product for the enterprise security and banking sector.

VASCO has built its leadership position in the dynamic password segment. During 2005, VASCO has reached the impressive amount of 20 million Digipass sold and delivered. In total, VASCO has sold over 7 million Digipass during the year 2005.

Digipass has started back in the early nineties as a product that was only distributed to selected corporate banking customers. It has now become a mass product for retail banking and other sectors. And with over 440 banks using our products, we are well equipped to cater all our customer's needs in the Digipass sphere. We truly are The authentication company.

The next step in our success story was to adapt our product strategy to allow us to win those markets out of the reach of the hard- or software Digipass products. We mean for example the highly secure USB protected certificate and PKI applications. But also the password technologies for people who buy a book a couple of times a year, who want to check their frequent flyer miles and book airplane tickets. We are not leaving our very successful product strategy, we will stay the Authentication Company. However, we add new products to our offerings. That way we become the full option, all-terrain authentication company.

With "full option", we mean that VASCO's Digipass Controller can support passwords, one-time passwords, certificates and biometrics. Contrary to some, VASCO does not believe in hype, and gives clear target dates for every one of those technologies.

VASCO is already world leader in the dynamic password and digital signature field, with its famous Digipass product line.

Starting Q2 2006, VASCO will support alternative password technologies. In Q1, we already won a first bank that will use VACMAN Controller to calculate codes that will be printed on a paper based TAN-lists.

Later this year, VASCO will add certificate/PKI client products to its product lines.

The announcement of our product partnership with the company Eutron from Italy was a first action in this field.

Depending upon market conditions, demand and the necessary development of technological infrastructure, VASCO will also be active in the biometrics sphere.

VASCO doesn't believe in biometrics as a stand-alone online authentication technology, but as an add-on for the current two-factor authentication standards, making the leap to three-factor authentication.

VASCO's R&D resources are fully focusing on all four above mentioned technologies.

"All-terrain" stands for the sectors, the professions using VASCO's Digipass and VACMAN products. All VASCO's Digipass products are developed to meet and surpass the banking sector's stringent security criterions. In a later phase, these banking-level security products are introduced in other sectors. Currently, VASCO's products are used in between 50 and 100 vertical applications, including online brokerage, e-government, e-gaming, automotive, sports, airline industry, travel, manufacturing industry and ... banking.

By becoming the full-option, all-terrain authentication company, VASCO gives a strong signal to its customers, prospects and partners. They can rest assured that VASCO will be able to offer them best-of-breed authentication products now and in the future. Customers will also be able to choose the authentication solutions that are best suited for them, their customers, their budget and their market. VASCO will offer "à la carte" authentication, from fast food to haute cuisine.

To cater our customer's needs, we need a tight service network. Therefore, VASCO has accelerated its hiring program. At the end of Q3, VASCO had over 110 employees. On December 31, we had 128 people working for us. I think that we have proven this quarter that we can grow without endangering our profitability.

Thank you.

**Ken Hunt Introduce Cliff Bown:**

At this time I would like to turn the call over to Cliff Bown, our Chief Financial Officer.

**CLIFF:**

As noted earlier by Ken, revenues for the fourth quarter and full year of 2005 were \$17.5 million and \$54.6 million, respectively, an increase of \$8.2 million or 88% over the fourth quarter of 2004 and an increase of \$24.7 million or 83% over the full-year of 2004. Revenues for the quarter and full-year included \$1.2 million and \$4.5 million, respectively, net of purchase accounting adjustments, from AOS-Hagenuk, which was acquired in February 2005. Revenues for AOS before purchase accounting adjustments for the quarter and full-year were \$1.2 million and \$5.0 million, respectively. Excluding the revenue from AOS, our revenue grew 76% over the fourth quarter and 67% over full-year of 2004.

Revenue for the fourth quarter of 2005 was 32% higher than the third quarter of 2005 if you include the AOS revenue and 35% higher than Q3 of 2005 if you exclude the AOS revenue.

Compared to 2004, the increase in revenue for the fourth quarter and full-year reflected significant increases from both the Banking and the Corporate Network Access markets. Revenues in the fourth quarter of 2005 from the Banking and the Corporate Network Access markets increased 101% and 34%, respectively. Revenues for the full-year of 2005 from the Banking and the Corporate Network Access markets increased 95% and 32%, respectively.

The distribution of our revenue in the fourth quarter of 2005 between our two primary markets was approximately 87% from the Banking and 13% from the Corporate Network Access. In the fourth quarter of 2004, approximately 82% came from the Banking and 18% came from Corporate Network Access.

The geographic distribution of our revenue in the fourth quarter of 2005 was approximately 65% from Europe, 5% from the U.S., 13% from Asia and the remaining 17% from other countries. It should be noted that revenue from each of the primary geographic areas, Europe, the United States and Asia, increased in the fourth quarter 2005 as compared to the fourth quarter of 2004. For the fourth quarter of 2004, 89% of the revenue was from Europe, 7% was from the U.S. and 4% was from other countries.

The geographic distribution of our revenue for the full-year of 2005 was approximately 72% from Europe, 7% from the U.S., 12% from Asia and the remaining 9% from other countries. For the full-year of 2004, 81% of the revenue was from Europe, 10% was from the U.S., 2% from Asia and 7% was from other countries. As was the case for the fourth quarter, revenue from each of our primary geographic areas increased for the full-year of 2005 as compared to the full-year of 2004.

Gross profit as a percentage of revenue for both the fourth quarter and full-year of 2005 was approximately 63% and compares to 65% and 69% for fourth quarter and full-year of 2004, respectively. The decline in gross profit as a percentage of revenue in 2005 compared to 2004 in both the quarter and full-year was primarily related to a lower average sales price, partially offset by lower average cost of product produced. The lower sales price reflects the increase in the size of deployments to our customers.

As has often been noted previously, our strategy of being the high-volume, high-quality, low-cost producer has positioned the company to compete effectively for the larger deployments of tokens, especially in the consumer market, and has resulted in significant increase in the number of tokens sold in each of the last four quarters. VASCO shipped approximately 2.4 million tokens in the fourth quarter 2005, which was 127% greater than the fourth quarter of 2004. For the full-year 2005, VASCO shipped approximately 7.3 million tokens, which was 159% greater than for the full-year 2004. The average selling price per token, including related software, was approximately \$7.22 for the fourth quarter of 2005 and \$7.44 for the full-year of 2005. In 2004, the average selling price per token, including related software was approximately \$8.70 for the fourth quarter of 2004 and \$10.54 for the full-year. As you will hear in a moment, the decline in average sales price and related gross margin have been more than offset by a decline in operating expenses as a percentage of revenue, all of which has resulted in an increase in operating profits, both in absolute dollars, as well as a percentage of revenue.

Operating expenses for the fourth quarter of 2005 were \$6.8 million, an increase of \$2.3 million or 50% from the fourth quarter of 2004. Operating expenses for the quarter included \$539,000 related to AOS, of which \$54,000 related to the amortization of intangibles assets arising from the acquisition. Excluding the AOS expenses, operating expenses for the quarter increased 39% over the fourth quarter of 2004.

Operating expenses for the full-year of 2005 were \$23.5 million, an increase of \$8.3 million or 55% from the full-year of 2004. Operating expenses included \$2.3 million related to AOS, of which \$367,000 were related to the amortization of intangibles assets arising from the acquisition. Excluding the AOS expenses, operating expenses for the year increased 40% over the full-year of 2004.

In addition to the expenses related to AOS, operating expenses increased in each of the three major categories, sales and marketing, research and development, and general and administrative when compared to the fourth quarter and full-year in 2004. The majority of the increases in expenses was in the sales and marketing area and were related to the Company's increased investment in sales staff and marketing programs.

It should be noted that while overall operating expenses increased, operating expense as a percentage of revenue declined. For the fourth quarter of 2005, operating expenses as a percentage of revenue were 39%, an improvement of 9.8 percentage points from the 48.8% reported for the fourth quarter of 2004. For the full-year of 2005, operating expenses as a percentage of revenue were 43.0%, an improvement of 7.7 percentage points from the 50.7% reported for the same period of 2004. As Ken has often mentioned in the past, we believe that the decline in operating expenses as a percentage of revenue reflects the leverage, or opportunity for improved operating productivity, that is in the Company's business model. By working through the distributor and reseller network and also as a result of selling larger quantities related to consumer applications, the Company is able to support higher levels of revenue without commensurate increases in its expense base.

Operating income for the fourth quarter of 2005 was \$4,208,000, an increase of \$2,715,000, or 182%, from the \$1,493,000 reported in the fourth quarter of 2004. Operating income for the full-year of 2005 was \$10,953,000, an increase of \$5,401,000, or 97%, from the \$5,552,000 reported in the full-year of 2004.

Operating income as a percent of revenue, or operating margin, was approximately 24% for the quarter and 20% for the full-year of 2005 and is 8.0 percentage points and 1.5 percentage points higher, respectively, than the same periods of 2004. The increase in operating margin is attributable to the reduction in operating expenses as a percentage of revenue partially offset by the decline in gross margins.

As we look forward, and as has been mentioned in previous calls, we plan to invest a portion of our increased operating profit in discretionary programs that will increase our sales and marketing capability, and over time, are expected to generate incremental revenues from new geographic regions or increase our penetration in existing markets.

Other income/expense was expense of \$7,000 for the fourth quarter 2005 compared to expense of \$538,000 for the same period in 2004. For the full-year 2005 other income/expense was income of \$506,000 compared to expense of \$539,000 for full-year 2004. The increase in other income and expense is primarily due to differences in exchange gain and losses that resulted from the combination of our increasing U.S. Dollar net asset position and the change in the exchange rate between the Euro and the U.S. dollar. In the May 2005, the Company initiated a program to hedge the income statement exposure to transactions gains or losses resulting from changes in currency rates.

The Company reported income tax expense of \$1,276,000 and \$3,827,000 for the fourth quarter and full-year of 2005, respectively. In 2004, the Company reported income tax expense of \$471,000 and \$1,880,000 for the fourth quarter and full-year, respectively. The effective tax rate was 30% for the fourth quarter and 33% for the full-year of 2005. The effective tax rate for the fourth quarter and full-year of 2004 was 48% and 37%, respectively. The rates reflect the company's earnings by tax jurisdiction and the lower rates in 2005 reflect an increase in earnings in countries in which the Company has net operating loss carryforwards that have been fully reserved for book purposes in prior periods.

Earnings before interest, taxes, depreciation, and amortization (EBITDA or operating cash flow if you will) from continuing operations was \$4.5 million and \$12.5 million for the fourth quarter and full-year of 2005, respectively. EBITDA in 2005 reflects an improvement of \$3.3 million or 276% from the fourth quarter of 2004 and an improvement of \$6.8 million or 118% for the full-year of 2004. The fourth quarter of 2005 reflected the twelfth consecutive quarter of positive operating cash flow.

The makeup of our workforce as of December 31, 2005 was 128 people worldwide with 80 in sales, marketing and customer support, 31 in research and development and 17 in general and administrative. The average headcount for the full-year 2005 increased by approximately 32 persons or 40% over the average full-year headcount in 2004

I would now like to make a few comments on the balance sheet. Our net cash balance and working capital balance increased from the prior quarter as a result the Company's strong operating performance. During the fourth quarter, our net cash balance, total cash less bank borrowings, increased \$4.7 million, or 51%, to \$14.0 million from \$9.3 million at September 30, 2005. Our working capital increased \$3.5 million, or 27%, to \$16.3 million from \$12.8 million at September 30, 2005. Bank borrowings noted on the balance sheet of \$3.2 million were borrowed under the line of credit and relate solely to our hedging program. There was no impact on working capital from the hedging program as the additional cash was offset by short-term debt.

During the quarter our Days Sales Outstanding in accounts receivable increased from 59 days at September 30, 2005 to 63 days at the end of the fourth quarter. The increase in DSO is primarily related to the increased volume of revenue recorded in last month of the quarter and was not yet due at the end of the year.

The Company continues to have no term debt. The Company has approximately \$300,000, as of December 31, 2005, available for additional borrowings under its line of credit that is secured by its receivables.

Now, I would like to turn the meeting back to Ken.

## **Comments on 1st Quarter and Full-Year 2006 – Ken Hunt**

First, I would like to comment on order backlog for Q1 2006. As of this date, we have firm orders with shipments scheduled for the 1st Quarter of approximately \$12.8 million. Any new orders received before quarter's end and shipped during the quarter would be additive to this number. This backlog shows the strength of our order flow, as it is 20% higher than the backlog going in to Q1 2005. In addition, the backlog is 12% higher than the \$11.4 million in revenues reported for Q1 2005.

Today, we are providing guidance for full-year 2006. As in the past, we only comment on annual numbers, not quarterly numbers. We estimate that our full-year revenue will grow 35%-45% in 2006 over 2005. We expect that full-year gross margins will be in the range of 58-63% of revenue. Finally, we are projecting that operating income will be in the range of 13-18% of revenue on a U.S. GAAP basis. Excluding amortization costs and the non-cash costs associated with the Company's equity and long-term incentive compensation plans, we expect that operating income will be between 15% and 20% on a proforma basis.

In summary, we are very pleased with what we have accomplished in 2005. As in the past, we will not rest on our laurels and be satisfied with past performance as a measurement of our future achievements. You can rely on VASCO's people to do their very best, always!

### **Q&A Session:**

This concludes our presentations today and we will now open the call for questions. As I mentioned earlier, as a courtesy to others on the call, I would appreciate it if you would limit your questions to an initial question plus a follow-up. If you have additional questions, please re-enter the queue after the answers to your initial questions have been given.

### **Operator**